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C O N F I D E N T I A L SECTION 01 OF 02 CARACAS 001236

SIPDIS

ENERGY FOR ALOCKWOOD AND LEINSTEIN, DOE/EIA FOR MCLINE
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E.O. 12958: DECL: 09/16/2019
TAGS: [EPET](#) [EINV](#) [ENRG](#) [ECON](#) [VE](#)
SUBJECT: VENEZUELA: INSIGHT INTO LUKOIL AND THE RUSSIAN
CONSORTIUM'S ACTIVITIES

REF: CARACAS 495

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Classified By: Economic Counselor Darnall Steuart, for reasons
1.4 (b) and (d).

11. (C) SUMMARY: Russian oil companies in Venezuela understand that government-to-government negotiations are the most expedient way to advance commercial relations in Venezuela. In addition to working through a consortium to sign new oil deals, the individual companies are preparing to transfer previous government-to-business deals to the Russian consortium. Recent exploration and certification activities in Venezuela's extra heavy crude Orinoco heavy oil belt (the Faja) may lead to a re-drawing of previously announced block borders to provide more equitable access to oil reservoirs for Russia, Belarus, and Vietnam. END SUMMARY.

Junin 6 and the Russian Consortium

12. (C) Sergey Sipunov, Lukoil's country representative, told Petroleum AttachQ September 12 that the Russian consortium expects to complete construction in the Junin 6 block of an upgrader that will be able to process 450,000 b/d of crude petroleum and to have its first commercial barrel of crude oil by 2016. (NOTE: The Russian consortium, comprised of Lukoil, Gazprom, TNK-BP, Rosneft, and Surgutneftegaz, was formed in 2009.) Press reports citing Minister of Energy and Petroleum Rafael Ramirez the week of September 14 indicated that the Russian consortium paid Venezuela a one billion dollar bonus for the rights to Junin 6.

13. (C) Sipunov (strictly protect throughout) shared that a Lukoil team would arrive in Caracas the week of September 14 to participate in negotiations over the Russian consortium's joint venture agreement with PDVSA. He expected that the consortium and President Chavez would sign the agreement in December 2009. Two pending areas of disagreement include whether the extra heavy crude oil will be upgraded to 16 degrees API (Russian position) or 32 degrees API (PDVSA's position) and where the upgraded synthetic crude will be

marketed. Lukoil wants to market the oil in the United States where it has over 2,000 service stations on the east coast. Sipunov said PDVSA has suggested that the Russians agree to look at other markets, such as Europe or India in order to avoid competing with Citgo. He also claimed that PDVSA is not fully satisfying any long term supply contracts.

Tangentially, Sipunov noted that Lukoil is interested in buying its first refinery in the U.S. to support its east coast downstream operations.

¶4. (C) Sipunov shared that the Russian oil and gas companies determined that the best strategy in Venezuela was to focus on government to government relations. He observed that "working through the government is key, it's political." He claims that the companies approached the Russian government requesting its assistance in negotiating with the GBRV. To facilitate this strategy, the companies formed a consortium to operate in Venezuela. In addition to the consortium's agreement with the GBRV to develop Junin 6 and its plans to bid on blocks in the Carabobo heavy oil round, the individual member companies have discussed transferring other exploration, development, and production rights each has independently secured with PDVSA to the consortium. Sipunov stated that Lukoil plans to transfer its rights in Junin 3 to the consortium. Other transfers could include Ayacucho 2 from TNK-BP and Ayacucho 3 from Gazprom. Sipunov raised the uncertain legal framework in Venezuela and the lack of international arbitration as potential obstacles (even though the GOR and the GBRV recently signed a bilateral investment treaty that provides for international arbitration seated in Stockholm).

Redrawing Blocks to Provide Access to Crude Reservoirs

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¶5. (C) According to Sipunov, the operators of the adjacent Blocks Junin 1-4 (Belarus in Junin 1, PetroVietnam in Junin 2, Lukoil in Junin 3, and CNPC in Junin 4) have discussed redrawing their respective borders with PDVSA as they have a clear understanding of where the oil and water reservoirs lie. He shared that Junin 3 does not have any crude oil, only water. (NOTE: Press reports indicate the MENPET certified with Ryder Scott the reserves in Junin 3 in July 2008, but the reservoir figures were not published.) With the exception of CNPC, the other two companies support the idea with the goal that adjusting the borders to reflect recent exploration would secure access for each company to a reservoir that could produce at least 200,000 b/d. The week of September 14, President Chavez announced a \$16 billion deal to develop the Faja with an unnamed Chinese company. An unidentified PDVSA director commented to the press on September 17 that the deal was with CNPC for Junin 4. If this is accurate, the deal to produce 400,000-450,000 b/d out of Junin 4 is twice the target production of 200,000 b/d announced in March 2007 when PDVSA and CNPC agreed to form a joint venture production company for the block. (NOTE: Per reftel, PDVSA appears open to redrawing block borders or awarding replacement blocks to partners if the original blocks granted do not have significant crude oil reserves.)

Circumventing Local Labor Laws Impact on Expats

¶6. (C) Sipunov explained that in order to circumvent local labor laws, Lukoil actually has two companies operating in Venezuela. He leads one office as the senior Lukoil official in Venezuela and a Canadian heads the other office. Sipunov claimed that foreign companies are allowed to employ nine expatriates, but, after the ninth, for each expatriate the company has to hire nine local employees. Thus, with two companies in Venezuela, Lukoil maintains upwards of eighteen expatriates without a corresponding requirement to employ eighty Venezuelans.

¶7. (C) COMMENT: The Russian's openness belied frustration after four years of experience in Venezuela and zero

production on his short-term horizon. The Russians have embraced the government-to-government model pushed by the Venezuelans that the Chinese, Iranians, Japanese, and other states have adopted. Even though the model is inefficient, it provides the Russian companies with access to Venezuela's vast petroleum reserves and reduces each company's individual risk exposure. We should expect to see increased interest from other states in expanding government-to-government relations to secure access to Venezuela's petroleum reserves.

If the recently signed Chinese oil deal involves Junin 4, then it would appear that they wanted to quickly lock up a reservoir that is expected to produce twice the forecasted amount of crude before PDVSA agreed to redraw the block borders with Russia, Belarus, and Vietnam. END COMMENT.
DUDDY